

Service Date: January 10, 1985

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application)	UTILITY DIVISION
of the City of Three Forks to Increase)	DOCKET NO. 84.6.34
Rates and Charges for Water Service.)	ORDER NO. 5105

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APPEARANCES

FOR THE APPLICANT:

William O'Leary, Attorney at Law, Arcade Building, Helena, Montana 59601.

T.H. Thomas, Representative Appointed by City, 1200 Twenty-Fifth Street South, Great Falls, Montana 59405.

FOR THE CONSUMER COUNSEL:

John Allen, Staff Attorney, Montana Consumer Counsel, 34 West 6th Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Opal Winebrenner, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

John Driscoll, Commissioner and Hearing Examiner

BACKGROUND

1. On June 22, 1984, the City of Three Forks (Applicant or City) filed an application with this Commission for authorization to increase rates and charges for water service to its customers in the Three Forks, Montana area. The Applicant requested an average increase of approximately 108% for an annual revenue increase of approximately \$61,700.

2. On September 14, 1984, a properly noticed public hearing was held in the V.F.W. Hall, Three Forks, Montana. The purpose of the hearing was to consider the merits of the Applicant's proposed water rate adjustment. At the close of the public hearing, the parties stipulated to allow the Commission to issue a Final Order in this Docket.

FINDINGS OF FACT

3. At the public hearing, the Applicant presented the testimony and exhibits of:

Gene Townsend, Mayor
Sharon G. Smith, City Clerk/Treasurer
Doug Daniels, Consulting Engineer/City Engineer
Tom Thomas, Consulting Engineer

These witnesses testified concerning: the need for proposed capital improvements, the estimated cost of proposed capital improvements, the financing of proposed capital improvements, projected debt service obligation of the water utility, the financial condition of the water utility and rate structure.

4. No public testimony was presented at the public hearing in opposition to any issue under consideration by the Commission in this Docket.

Proposed Capital Improvements

5. The City has proposed a three phase capital improvement program. Table 1 below provides a summary of the three-phase capital improvement program and includes the estimated cost of the improvements.

TABLE 1

<u>Construction Phase</u>	<u>Estimated Cost</u>
<u>Phase I</u>	
Eliminate arsenic problem through development of a new source of supply.	\$659,000
<u>Phase II</u>	
Repair existing water tank	\$ 32,000
Reconstruct transmission line from reservoir	\$108,000
Construct water mains to service Buttelman Addition	<u>\$ 36,000</u>
Total Cost Phase II	\$176,000
<u>Phase III</u>	
Construct 500,000 gallon reservoir	\$200,000

6. Phase I of the City's proposed capital improvement program is the development of a new water supply source with acceptable levels of arsenic. The City is under a federal mandate to develop a water supply source in compliance with the arsenic level standards contained in the Safe Drinking Water Act. Since this improvement is federally mandated, the provisions of Title 69, Chapter 7, MCA, apply. The Commission therefore, has no jurisdiction to determine the appropriateness of the proposed capital improvements.

The Commission debt service findings will address the financing of Phase I capital improvements, as outlined by the City, in an effort to reflect the overall revenue impact of the proposed capital improvement program on consumers.

7. Phase II of the capital improvement program reflects the City's determination of what improvements should be made to the system to insure continued adequate provision of service to consumers.

Item 1 of Phase II capital improvements is the repair of the existing 250,000 gallon water storage tank, which is in a deteriorated condition, specifically the roof over the structure needed replacement.

Item 2 under Phase II capital improvements is the reconstruction of the transmission line from the reservoir to town. This transmission line is a continual maintenance problem and its advanced stage of deterioration warrants its replacement.

Phase II, Item 3 capital improvements call for the replacement of distribution mains in the Town's Buttelman Addition. The distribution mains in this area were inadequately sized causing inadequate pressure to be experienced by consumers located in the area.

8. The Phase III construction of a 500,000 gallon reservoir, is not under consideration in this Docket because the City has decided to defer its construction until a later date.

9. The City's proposed capital improvement program was not challenged by any party participating in this proceeding. The Commission, having considered the testimony of the City that its existing storage facility is in a state of disrepair, that the transmission line from the reservoir to town is deteriorated and a continual maintenance problem and that pressure problems are being experienced by consumers of the water utility service, finds that it is prudent for the City to construct the proposed capital improvements outlined in Phase II of Table 1, to correct these deficiencies.

The Commission also finds the City's estimated cost of \$176,000 for constructing improvements outlined to be a reasonable estimate.

Debt Service

10. The City proposes to finance the capital improvement program (Phases I and II) outlined in the preceding Findings of Fact through the issuance of revenue bonds. The purchasing of the bonds would be by the Montana Department of Natural Resources and Conservation (DNRC).

The City is proposing the issuance of \$435,000 in revenue bonds to be repaid over a period of 20 years with an interest rate of 7% during the first years, and 10.26% for the remaining 15 years.

Under this financing, the City proposes a bond reserve in an amount equal to the maximum principal and interest payment on the bonds, and to provide a debt service coverage of 125%.

11. It is the Commission's understanding of DNRC policy, that if a City has a currently outstanding revenue bond issue, DNRC adopts the provisions of that bond indenture for purposes of establishing revenue bond reserve requirements and debt service coverage. If the City does not have a current outstanding revenue bond issue, the only requirement DNRC places in its bond indenture, as relates to a reserve and bond coverage, is that the City establish a bond reserve in an amount equal to 6 months principal and interest payment on the bond.

12. In any sale of municipal revenue bonds, the purchasers of the bonds must be assured that their investment is secure. To provide this security, the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to make the bond's principal and interest payments as they come due. Generally accepted bonding practices provide for the inclusion of covenants in the revenue bond indenture which require the establishment of a revenue bond reserve in an amount equal to one year's principal and interest payment, and the provision of a debt service coverage ratio, ranging from 110% to 130%.

13. DNRC, in its revenue bond indenture, is proposing the requirement that the City establish a revenue bond reserve in an amount equal to six months principal and interest payable on the bond. The Commission finds this bond covenant, establishment of a reserve fund, to be among the standard requirements and, therefore, accepts the requirement.

14. DNRC is not proposing a requirement that the City provide a debt service coverage as additional security for its investment. Generally, purchasers of revenue bonds place a debt service coverage in the bond indenture. There are two reasons for placing this requirement in the indenture, the first is to assure that the rates implemented by the municipal utility will produce revenues that exceed the cost of providing service (operation and maintenance expense plus debt service), thereby assuring the bond purchaser that bond payments will always be made. The second reason is that generation of net revenues, which are unencumbered, provide the municipal utility with a source of funds that can be used for replacement of minor capital items. This funding source for replacement of minor capital items is the bond purchasers' attempt to ensure adequate maintenance of utility

facilities, which results in additional security for the investment, because adequate maintenance translates to continued operation of the utility.

15. Even though DNRC has not included a debt service coverage requirement in its proposed bond indenture as additional security for its investment, the Commission is of the opinion that one should be used in determining the overall revenue requirement of the utility. This Commission supports funding of an on-going capital maintenance program to insure adequate maintenance of existing utility facilities. In its application, the City indicates that its only source of funding for this type of program would be the 125% coverage ratio which it had proposed. Given this fact, and to insure minimal on-going capital maintenance, the Commission finds it appropriate to allow a 125% coverage ratio in the overall revenue requirement of the City.

16. Based on the preceding Findings of Fact, the Commission finds that the applicant should be authorized to issue \$435,000 in revenue bonds with a term of 20 years and an interest rate of 7% during the first 5 years and 10.26% for the remaining 15 years. The Commission also finds that the bond issuance should contain the requirements that the City establish a bond reserve in an amount equal to 6 months debt service on the bond and provide a debt service coverage of 125%.

17. The proposed revenue bond issue will have an annual principal and interest payment of approximately \$42,000, \$25,000 for Phase I which is mandated, and \$17,000 for the improvements in Phase II which were approved by the Commission. These expenses, were not challenged by any party and are accepted by the Commission.

18. The provision that the City be allowed a debt service coverage of 125% means that the City should have a net operating income of \$10,500. To determine net operating income, operation and maintenance expense, as well as total debt service, are subtracted from the total revenues of the utility. The required net operating income is calculated by multiplying the annual debt service on the bond issue by 25% ($\$42,000 \times .25 = \$10,500$).

Operation and Maintenance Expense

19. The test year in this case is the fiscal year ending June 30, 1984, adjusted for inflation. The test year operation and maintenance expenses totaling \$70,800 were not challenged by any party participating in this proceeding, and are accepted by the Commission.

20. Based on Findings of Fact Nos. 17, 18 and 19, the Commission finds the following test year operating deductions to be reasonable:

Operating Expenses	\$ 70,800
Debt Service	42,000
Coverage Ratio	<u>10,500</u>
TOTAL	\$123,300

Revenue Need

21. The City indicated, that under present rates which became effective April, 1983, user charges would generate approximately \$57,000 in annual revenues. The test period user charge revenues, as calculated by the Applicant, appear to fairly reflect revenues that would be generated, under present rates, and are, therefore, accepted by the Commission.

22. The City's water department has sources of revenue other than user charges, which include:

Sale of Material	\$1,000
Hook-up Fees	700
Interest Earnings	<u>2,900</u>
Total Other Income	\$4,600

The "Other Income" as presented by the Applicant appears to fairly reflect revenues that can be anticipated from these sources, and are accepted by the Commission.

23. The Commission, based on Findings of Fact Nos. 21 and 22, finds the total test period operating revenues are \$61,600.

24. The Commission, based upon Findings of Fact contained herein, finds that the Applicant should be allowed to increase annual revenues by \$61,700. This requirement is calculated as follows:

Operating Revenues	\$ 61,600
LESS:	
Operating Expenses	\$ 70,800
Debt Service	42,000
Coverage Ratio	<u>10,500</u>
Total Revenue Requirement	\$123,300
REVENUE DEFICIENCY	\$ 61,700

Rate Design

25. In its application, the Applicant has proposed the implementation of a rate structure that includes a monthly customer charge and two declining rate blocks to generate the revenues determined appropriate in this order. The proposed rate structure would be replacing a rate structure that includes a minimum charge and four declining rate blocks.

26. There was discussion on the record relative to the City's decision to continue a declining block rate structure in view of the fact that declining block rates are in conflict with efficient resource management, and provide an incentive to increase consumption into lower priced tail blocks. To provide an incentive to increase consumption results in an inefficient allocation of the natural resource and often times necessitates an increase in plant capacity.

The City stated that it was aware of the problems associated with a declining block rate structure, but had decided to perpetuate a declining block rate structure in this case to lessen customer impact. The City indicated that being cognizant of the problems associated with a declining block rate structure would prompt it to ultimately eliminate this type of rate structure.

27. The Commission, given the rationale behind the City's decision to continue a declining block rate structure, finds the rate structure proposed by the Applicant to be acceptable.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this proceeding. Title 69, Chapter 7, MCA.

2. The Commission afforded all interested parties in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA.

3. The rates approved herein are reasonable, just and proper. Section 69-3-201, MCA.

ORDER

THEREFORE, THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. The City of Three Forks shall file tariffs, consistent with the Findings of Fact herein, which reflect an increase in annual revenues of \$61,700.

2. The City of Three Forks shall implement a rate structure consistent with Finding of Fact No. 25 including a monthly customer charge and two declining rate blocks to generate the revenues approved in this Order.

3. The rates approved herein shall become effective upon Commission approval.

DONE IN OPEN SESSION this 7th day of January, 1985 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Clyde Jarvis, Chairman

John B. Driscoll, Commissioner

Howard L. Ellis, Commissioner

Tom Monahan, Commissioner

Danny Oberg, Commissioner

ATTEST:

Trenna Scoffield
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.